$50.00 ANNUALLY
40 Letters Per Year

Dow Theory Letters

"The Market as Interpreted under the Dow Theory"

RICHARD RUSSELL
125 East 93rd Street
New York City 28

Registered with the Securities and Exchange Commission

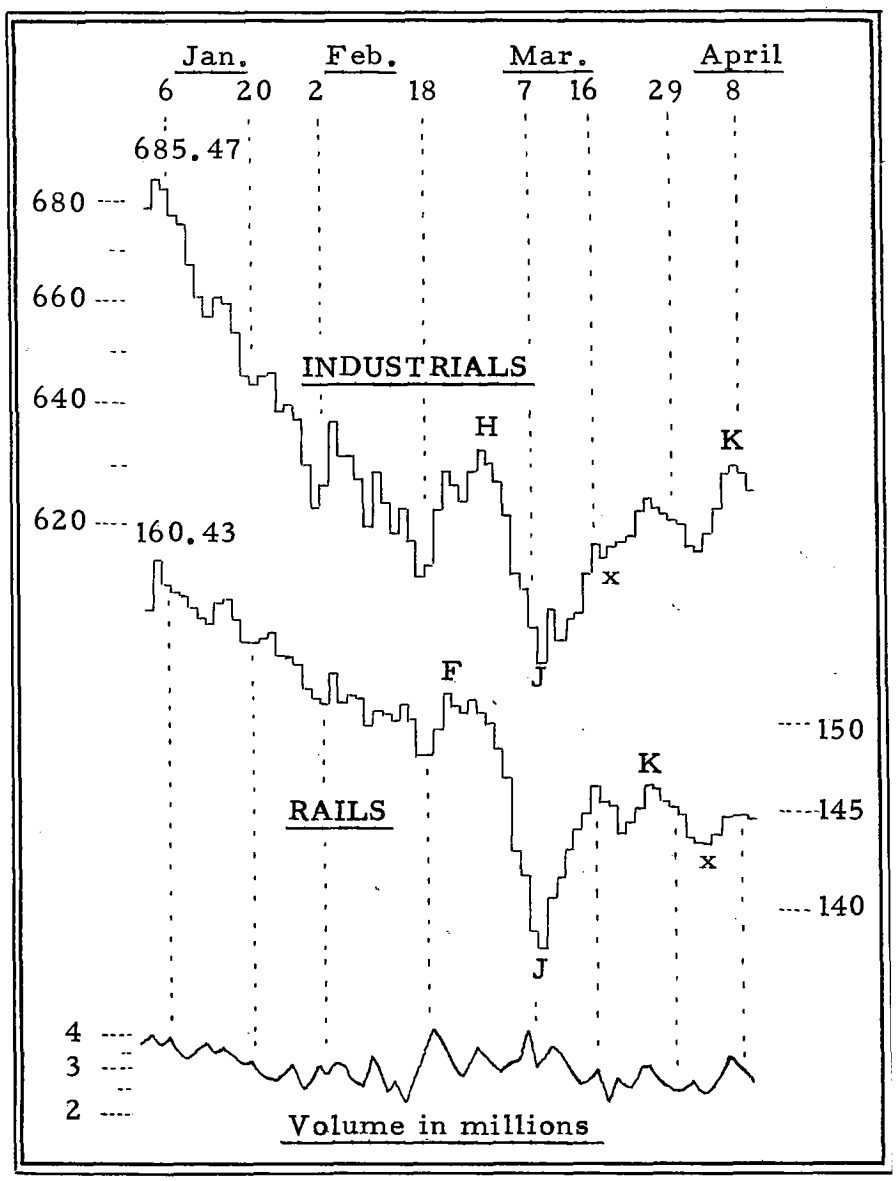
Copyright 1960 - Richard Russell

CURRENT MARKET. In the last Letter (#99) I discussed the "line" structure which was forming in the Averages. Dow first recognized lines as areas of carefully matched accumulation or distribution. We might remember, however, that Dow was writing about a market in which the Averages fluctuated within a price range of perhaps 40 to 120. In those days when the two indicators moved within an area of 3 or 4% the appearance of the resultant structure clearly resembled a horizontal line on the charts.

After studying every line structure ever referred to by Hamilton, Rhea came up with the following definition: "A 'line' is a price movement extending two to three weeks or longer, during which period the price variation of both Averages moves within a range of approximately five per cent."

As mentioned in Letter 99, a line suggests not only a series of narrow price fluctuations but it also suggests that the two Averages are in equilibrium. In order for valid inferences to be drawn from line breakouts, both Averages must penetrate the same side of the line, preferably on increasing volume. If a line is broken topside, then, obviously the buying within the line was superior to the selling. If the line is broken downside the selling was superior to the buying. Hamilton noted that when a line is in the process of formation, it is the hardest thing in the world to tell whether the accumulation (buying) was better than the distribution (selling).

On March 31 the Rails violated the lower limits of the current line, but this penetration was not confirmed by Industrials. For this reason the Rail move was meaningless. On April 6 the Industrials bettered their upper line limit, and this time the Rails would not confirm. As far as the Dow Theory is concerned, the upside Industrial penetration was no more significant than was the downside Rail penetration, since neither move was confirmed by the other Average.



When a single Average breaks out of a line formation and then works back within the line, the line limits should be extended to include the new point. Because of the two recent unconfirmed line breakouts we must now fix the upside line limits as follows: Industrials 629.03 (K), Rails 146.56 (K). The lower line limits are Industrials 615.09 (x) and Rails 143.41 (x). Joint penetration by the Averages through either side of the line on increasing volume should provide the first indication as to the next broad movement of the market.

If the line is broken topside the February highs (Industrials at H -- 632.00, Rails at F -- 151.90) will be the resistance points to watch. The critical points on the downside are the lows at J (Industrials 599.10, Rails 138.18). A bettering of the February highs would mean that a full secondary reaction (in a bear market) was in progress. A violation of the two J points would indicate that the primary bear trend was extending itself.

The primary and secondary trends are down; the minor trend is obscure.

WALL STREET FROM AFAR. I have just come back from a fine vacation, having absented myself from the supposed "New York nerve center" for a period of nine days. During my vacation I indulged in a minimum of "market talk", and it seems to me that in some ways this has its advantages. These Letters have a fairly wide geographic distribution with perhaps 15% of our subscribers in New York, 80% scattered throughout the United States and Canada and the remaining 5% in foreign lands.

While on vacation I merely kept up my chart of the daily closing prices of the D-J Averages and volume. Such a chart provides one with perhaps 80% of the information needed in order to trade successfully under Dow's Theory. At crucial turns it is useful, of course, to have "the feel" of the psychology of the country, the latter only because it is helpful to be able to sense "over-bought" and over-sold" markets. Psychology is also important in identifying market phases (see Letter 98). There is little doubt in my mind, however, that if I were forced to choose between (1) reading all the available financial news and opinions (without having access to the Averages) or (2) being on a deserted island with only the closing Average prices and volume, I would not hesitate to choose the latter (as far as making money in the market is concerned).

Dow's Theory is predicated on the ability of the Averages to see further and more accurately than the most informed board of directors, the most illustrious gathering of economists or the latest poll of consumer and business opinion. The superior wisdom of the Averages has proved itself on many hundreds of occasions throughout market history.

The Wall Street Journal had many "out-of-town" readers in 1900, and perhaps for this reason Dow wrote a few editorials which commented on the advantages and disadvantages of trading stocks away from "the Street". One or two quotes from those wonderful old editorials might be instructive at this time.

"In trading for five or ten points (a large profit in those days) the operator in an interior (out-of-New York) city has one advantage. He does not hear the rumors and see sudden movements in prices which are the bane of the office (New York) trader."

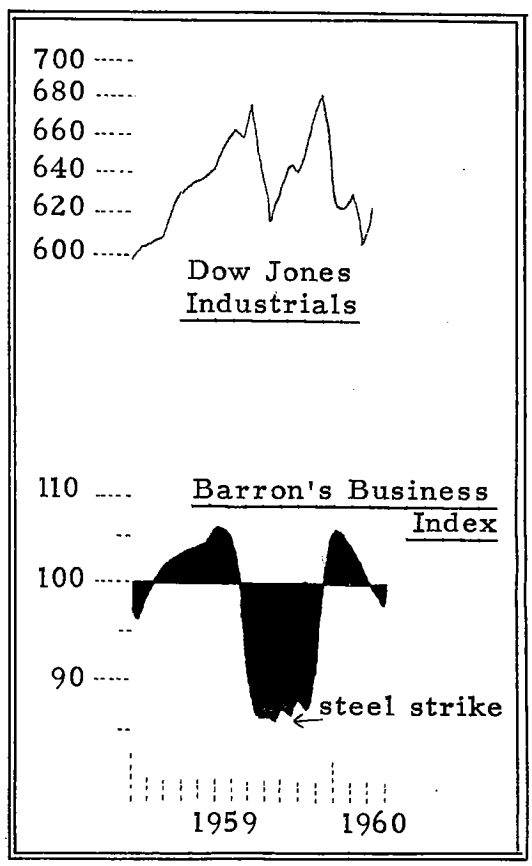
"An out-of-town operator can do all this just as well as an office trader and in some respects better. Some of the large operators like to go away from the market and work from Newport or Saratoga or other distant points in order to look at the trading from an unbiased mind and without being unsettled by the rumors that always grow out of any special move. The outsider who will wisely study values and market conditions and then exercize patience enough for six men will be likely to make money in the market."

NEWS. Flying back from California I had a chance to catch up on some of my financial reading (12 assorted issues of Wall Street Journals and New York Times), and it is most interesting to observe the steadily mounting mass of conflicting economic news which is filling the business pages. An economist could now build a good case for either side, depending on whether he was bullish or bearish. At such times the Averages alone are capable of examining the evidence and rendering the correct verdict. Hamilton, a trained observer as well as a Dow Theorist, knew this when he wrote, "The stock market barometer takes account of dear money and pig iron furnace operations, together with crop prospects, grain prices, bank clearing, political prospects, foreign trade, savings bank figures, wages, volume of railroad freight and a hundred other things. The average price of active stocks is the result of all this, impartially reflected in a market which no interest is big enough to influence."

The Averages, by rendering a bear signal, have signified that the great tide of the market and the economy is down. Yet no knowledge of the stock market barometer will enable us to predict the rapidity, duration or extent of a primary movement. When the current line is broken, we will have our first hint as to whether the economy will accelerate its "slowing-down" process or whether there will be a "holding" action or even a temporary improvement in the business picture over the coming months.

A joint upside penetration of the line would give the bulls a "breather". Conversely, a violation of the lower line limits would point to a stepping-up of the bearish factors in the economy.

BARRON'S INDEX AND THE AVERAGES. I have included a tracing of my chart of the D-J Industrials and Barron's Business Index. Barron's Index is adjusted for population and growth trends; 100 equals the 1935-39 period. The chart graphically demonstrates the thesis that the Averages render their decision well before the event. As we know, the January 5 high of 685.47 was unconfirmed by Rails, following which both Averages broke their previous lows thus giving a bear signal. From the 106.7 peak established in the first week in January, Barron's Index has dropped to an April 11 reading of 98.1. This means that business, as measured by Barron's Index, has already dropped over 8% in a little over three months.



TREASURY BILLS. Some months ago I suggested that a fine place to put money during a bear market was in 91 day Treasury bills. At that time the 91 day bills were yielding a record 4.6%. Recently, the yield on bills fell to the 2.6% area, and some subscribers asked me what to do with bills that had been bought earlier and were maturing. I suggested buying new bills in the open market with a maturity of one month away. This I did myself, and now the bill yields are turning violently up again. 91 day bills have dropped precipitously over the last week and yields have surged to better than 3.5%. I continue to believe that bonds are in a major bear market of their own (with a long-term bull market in yields), and that should a liquidity crisis occur, investors might get a chance to buy Treasury debt at the biggest bargain prices in history. In order to take advantage of such an occurrence, however, an investor must have cash (or short-term Treasury bills, the equivalent of cash).

(Written - April 12th, 2 P.M.)